

DAUFUSKIE ISLAND UTILITY COMPANY, INC.

DOCKET NO. 2014-346-WS

PRE-FILED TESTIMONY OF LYNN M. LANIER

BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION

[Prepared for De Novo Hearing]

Testimony Prepared: November 16, 2017

Hearing Date: December 5, 2017

1 **Q: PLEASE STATE YOUR NAME, EMPLOYER AND BUSINESS ADDRESS.**

2 **A.** My name is Lynn M. Lanier and I am employed by GDS Associates, Inc. (“GDS”), a
3 utility consulting and engineering firm with its principal offices in Marietta, GA. Until
4 12/31/16 I was a Principal in the Firm, but am now semi-retired and am an Executive
5 Consultant. My business address is 1850 Parkway Place, Suite 800, Marietta, GA
6 30067.

7 **Q. ARE YOU THE SAME LYNN M. LANIER, WHO TESTIFIED IN THE**
8 **HEARING BEFORE THE PSC ON THIS MATTER ON OCTOBER 28, 2015?**

9 **A.** Yes, I am.

10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS MATTER?**

11 **A.** The purpose of my testimony is to:

- 12 • Incorporate the rate base adjustments and expense adjustments proposed by my colleague
13 Mr. Charles Loy into our view of Daufuskie Island Utility Company, Inc.’s (DIUC’s or
14 “the Company’s) revenue requirements;

- 1 • Recommend alternative revenue requirements and overall revenue impacts, including
- 2 appropriate operating expense levels,
- 3 • Demonstrate that the representations made by the Company as to its financial distress are
- 4 inaccurate and overstated, and finally,
- 5 • Demonstrate that by comparison to other water and sewer utility service providers in the
- 6 area, the Company's proposed rates are unreasonably high.

7 **Q. WHAT IS THE OVERALL EFFECT OF YOUR PROPOSED ADJUSTMENTS**
8 **ON THE COMPANY'S REVENUE REQUIREMENT AND INCREASE OVER**
9 **PRESENT REVENUES?**

10 **A.** As I will outline in detail, in the balance of this testimony, I have determined that, based
11 on Mr. Loy's recommendation for applying "paid-in capital" to "CIAC", the increase in
12 the Company's overall revenue requirement for the combined water and sewer systems is
13 \$219,993, which would represent an increase over present adjusted revenues of 20.5%.
14 For the Water System, the increase in revenue requirements would be \$169,694 or a
15 31.3% increase, and for the Sewer System, the revenue requirement increase would be
16 \$50,298 or an increase of 9.5%. Under Mr. Loy's alternative recommendation of
17 applying utilization factors to the Company's plant balances to remove the unutilized
18 plant, the overall increase in revenue requirements for the combined water and sewer
19 systems would be \$269,499, representing an increase over present revenues of 25.1%.
20 For the Water System, the increase in revenue requirement would be \$160,779,
21 representing an increase of 29.6%, and for the Sewer System, the increase in revenue
22 requirement would be \$108,719, representing an increase of 20.5%.

1 **Q. ARE YOU AWARE OF THE S.C. SUPREME COURT'S DECISION**
2 **ADDRESSING THE COMPANY'S APPEAL OF THE COMMISSION'S RULING**
3 **IN THIS MATTER?**

4 **A.** Yes, I am.

5 **Q. HAVE YOU REVIEWED THE DIRECT TESTIMONY OF MR. GUASTELLA**
6 **AND MR. WHITE, FILED OCTOBER 18TH FOR THE REHEARING OF THIS**
7 **MATTER BEFORE THE COMMISSION?**

8 **A.** Yes, I have.

9 **Q. AND DO YOU AGREE WITH THE TESTIMONY OF MR. GUASTELLA AND**
10 **MR. WHITE?**

11 **A.** No, I do not.

12 **Q: WHAT ARE YOUR DISAGREEMENTS?**

13 **A:** As outlined in his rehearing testimony, my colleague, Mr. Loy, has recommended
14 adjustments to the Company's proposed Rate Base. I have incorporated those changes
15 into my proposed revenue requirements calculation, along with my proposed adjustments
16 to power cost, bad debt expense, and property taxes, along with adjustments to revenues
17 and expenses made by ORS and reflected in Ivana Gearheart's testimony and the
18 Settlement Agreement, from the first hearing, and determined that the overall revenue
19 requirement for the combined water and wastewater systems of the Company is
20 \$1,293,571, representing an overall increase in existing revenues of 20.5%. This increase
21 is significantly less than the 108.9% increase sought in the Company's original
22 application and the 125.7% increase that Mr. Guastella asserts, in his rehearing direct
23 testimony, could now be justified.

1 **Q. WHAT CHANGES ARE YOU PROPOSING TO THE COMPANY'S RATE**
2 **BASE?**

3 **A.** In his testimony, Mr. Loy proposed three adjustments to the Company's Rate Base: 1)
4 recording donated Property Plant and Equipment as a Contribution in Aid of Construction
5 (CIAC) instead of "Paid-in Capital"; 2) recording accumulated depreciation expense
6 appropriately for the Net Plant of the Company; and (alternatively) 3) reducing the
7 Company's Plant to reflect that percentage of Plant that is actually "used and useful" by
8 the Company.

9 **Q. DESCRIBE THE PROCESS BY WHICH THE COMPANY ADDED CERTAIN**
10 **PROPERTY, PLANT AND EQUIPMENT TO ITS BALANCE SHEET.**

11 **A.** In Haig Point Utility Company's (the predecessor in name to DIUC) 2005 rate case, the
12 Company proposed adjustments to add \$4,339,598 to Property, Plant, and Equipment to
13 the balance sheet, which was described in the accompanying note as
14

15 "To tie to Thomas & Hutton property schedule (\$1,711,549 water and \$2,628,049
16 sewer)." [See Exhibit CEL-R1 to Mr. Loy's Direct Testimony]

17 As Mr. Loy noted in his testimony, this is the first time that Property, Plant, and
18 Equipment had appeared on the Company's balance sheet. The Company then proposed
19 an offsetting adjustment on the Liabilities and Equities side of the balance sheet of "Paid
20 in Capital" in the amount of \$4,635,782 [Also, see Exhibit CEL-R1 to Mr. Loy's Direct
21 Testimony], which, according to the notes on the Company's exhibit, states

22 "To record plant and equipment and other adjustments to paid in capital."

23 **Q. WHY WAS BOOKING THE ADJUSTMENT TO "PAID-IN CAPITAL" AN**
24 **ERROR?**

1 **A.** As stated by Mr. Loy in his testimony, the adjustment to “Paid in Capital” was erroneous
2 and, instead, the offsetting adjustment should have been booked as “Contributions in Aid
3 of Construction (CIAC)”, because the plant was donated to HPUC by Haig Point, Inc..
4 The effect of booking the offsetting adjustment to CIAC is a credit to the liability side of
5 the Company’s balance sheet to reflect the appropriate offset to the donated Property
6 Plant and Equipment entry made on the asset side of the balance sheet. If this had been
7 properly booked, as of June 30, 2004, the CIAC would have completely off-set the
8 donated plant in Rate Base. This erroneous transaction has been continued on the
9 Company’s books all the way up to the present, although the rate base calculations were
10 challenged by ORS in the 2005 rate case, by ORS and intervenors in the 2012 rate case,
11 and in this current rate case.

12 **Q. WHAT IS THE EFFECT ON RATE BASE ASSOCIATED WITH MR. LOY’S**
13 **PROPOSED CHANGES?**

14 **A.** As shown on Schedule C-2 of my **Exhibit LML-R3**, the Rate Base would be reduced
15 from \$6,934,861 for the combined systems to \$2,304,944. For the Water System, the
16 Rate Base would be reduced from \$3,144,900 to \$1,379,638, and for the Sewer System,
17 the Rate Base would be reduced from \$3,789,961 to \$925,306.

18 **Q: HAS MR. LOY PROPOSED ANY ADJUSTMENTS TO DIUC’S DEPRECIATION**
19 **EXPENSE AND ACCUMULATED DEPRECIATION?**

20 **A.** Yes. Mr. Loy has also demonstrated that the Company incorrectly calculated depreciation
21 expense and accumulated depreciation on its Property Plant and Equipment and that the
22 Company has greatly under-depreciated its plant investment. His proposed changes
23 would increase the accumulated depreciation, thus reducing the Company’s Net Plant

1 value, as used in the Rate Base Calculation. This is shown on my Schedules C-1, C-2,
2 W-1, W-2, and S-1 and S-2.

3 **Q: HAS MR. LOY PROPOSED ANY ADJUSTMENTS RELATED TO WHETHER**
4 **DIUC'S PLANT INVESTMENT IS "USED AND USEFUL"?**

5 Yes. Mr. Loy has demonstrated in his testimony, as an alternative to the accounting
6 adjustment to reclassify paid-in capital to CIAC, that a substantial portion of the
7 Company's Plant Investment is not used and useful, and therefore, an adjustment should
8 be made to remove from Rate Base the portion of the Company's investment that is not
9 used and useful.

10 **Q. WHAT ARE YOU PROPOSING AS TO THE COMPANY'S EXPENSES TO BE**
11 **INCLUDED IN THE REVENUE REQUIREMENT?**

12 **A.** In its Application, the Company asserted that its combined water and sewer Operating
13 Expenses for the year ended 12/31/14 were \$1,037,747, and proposed adjustments of
14 \$334,186, resulting in Total Operating Expenses (Pro Forma) of \$1,365,076. Notable in
15 this large adjustment of 32.2% to Operating Expenses, were an increase in electric power
16 cost of \$51,281, a "decrease" in bad debt expense of \$90,905, an increase of \$113,655 for
17 amortization expense, and an increase of \$188,092 for property taxes. In my direct
18 testimony for the first hearing in this matter, I was critical of the overall increase in the
19 Company's operating expenses and of the Company's Management Agreement with
20 Guastella & Associates (GA), and I specifically recommended a decrease in the
21 Company's Electric Power Cost adjustment of \$34,841, based the information provided
22 by the Company.

1 In her testimony, ORS witness Ivana Gearheart, proposed adjustments to the Company's
2 expenses of \$64,311 for the combined system and \$19,375 for the Water System and
3 \$44,936 for the Sewer system. In the Settlement Agreement between ORS and
4 Intervenors, ORS changed its adjustment for bad debt expense, to accept the Company's
5 adjustment in its filing of a decrease of \$90,905. As reflected on Settlement Exhibit ICG-
6 3, this resulted in a decrease in operating expenses for the combined system of \$26,883,
7 and \$26,314 for the Water System and \$569 for the Sewer System.

8 In the Company's direct testimony for the rehearing, the Company accepted all of the
9 ORS adjustments to expenses, except for the outside management services and bad debt
10 expense from the Settlement Agreement, and depreciation, Amortization, and Property
11 Tax Expense, which is related to back property taxes, and the current Property tax
12 amount.

13 In my proposed revenue requirements, as shown on Schedules C-4, W-4, and S-4 of my
14 **Exhibit LML-R3**, I have incorporated the expense adjustments proposed by ORS and
15 accepted by the Company. However, in addition, I have also used the bad debt expense
16 adjustment included by the Company in its Application, and also made adjustments to the
17 Depreciation Expense, Amortization Expense (including the amount associated with back
18 property taxes) and the Property Tax amount, to reflect the taxes that should be expected,
19 based on the adjusted Rate Base.

20 **Q. WHAT IS THE BASIS FOR YOUR ADJUSTMENT TO BAD DEBT EXPENSE,**
21 **WHEREIN YOU ACCEPTED THE BAD DEBT EXPENSE AS FILED BY THE**
22 **COMPANY IN ITS APPLICATION?**

1 **A.** In the Company's application from Schedule A-4, I calculated the Bad Debt Expense to
2 be an extremely high 10.1% of revenue, excluding "Misc. Other Revenues". Such a rate
3 of bad debt expense is unheard of and simply cannot be justified. This amount is also far
4 in excess of what the Company proposed in its 2012 rate case of \$25,423, which ORS
5 then adjusted down to \$9,332 (ORS Witness C. Stutz, Audit Exhibit CAS-1, Page 1 of 2).
6 In its Application, the Company, properly in my opinion, reduced the bad debt expense
7 by \$90,905 to a much more reasonable amount of \$14,762, which results in a bad debt
8 expense rate of 1.4% of adjusted test year revenues (excluding misc. other revenues), a
9 much more reasonable level. Surprisingly, ORS witness Gearheart adjusted the bad debt
10 expense back to the Company's actual test year expense of \$105,667, making only a
11 minor adjustment of \$284,

12 "Adjustment 4(j) – ORS proposes to adjust bad debt expense at a rate of 0.5%
13 applied to pro forma revenues. ORS computed total bad debt expense of
14 (\$105,384), less the per book amount of (\$105,668), for a total adjustment of
15 (\$284)."

16 Furthermore, in her Audit Exhibit ICG-4 (p. 3 of 9), item 11 (4(j), she described the bad
17 debt adjustment as

18 "To adjust bad debt expense to reflect test period revenue write-off percentages
19 applied to ORS pro forma revenues under present rates."

20 **Q: DID ORS WITNESS GEARHEART CALCULATE BAD DEBT EXPENSE AT A**
21 **RATE OF 0.5% APPLIED TO PRO FORMA REVENUES?**

1 A. She did not. Even though a rate of 0.5% applied to revenues would be an appropriate rate
2 for bad debt expense, Ms. Gearheart instead applied a rate of 9.816% [DIUC's per book
3 bad debt expense (\$105,668) as a percentage of its annual revenue (\$1,076,463)]
4 multiplied by the ORS pro forma adjusted revenues of \$1,073,577, to arrive at a figure of
5 \$105,384.

6 **Q. WHAT WAS THE BASIS OF THE COMPANY'S ADJUSTMENT OF A**
7 **DECREASE OF \$90,905 TO BAD DEBT EXPENSE?**

8 A. My recollection is that at some point, Mr. Guastella was asked this question and he
9 responded something to the effect that the Company had adjusted the Bad Debt expense
10 down in an effort to achieve a more balanced level of expenses, for the purpose of the
11 Application. However, the Company's intent was clear in providing its response to ORS
12 Water/Wastewater Department July 23, 2015 Requests, item 6.2, where the Company
13 stated,

14 "The test-year bad debts reflect the write-off of accounts that were well
15 past due, in most cases in excess of one year, or delinquent amounts
16 adjusted out of receivables for charges judged to be uncollectible (ex.,
17 unpaid late charges on otherwise satisfied accounts). This was done in an
18 attempt to "clean-up" the receivables account and improve the
19 management of customer billing records. **The pro forma bad debt**
20 **expense in the rate application does not reflect the test-year levels, but**
21 **instead reflects a reasonable forecasted level of expense. (bold for**
22 **emphasis added)** In the future, the customer receivables, delinquent
23 based on a receivables aging, will be recorded in the reserve "Provision

1 for Uncollectible” account and written-off as a bad debt. Any subsequent
2 payment received on an amount written-off will reduce both the
3 uncollectible reserve and bad debt expense.”

4 I think it’s pretty clear that the test year booked amount was not a realistic amount for the
5 purpose of establishing revenue requirements and I think the Company recognized that
6 and made an adjustment to reflect a reasonable level of bad debt expense for future years.
7 In researching this matter further, I went back to the 2012 Rate Case and the testimony or
8 ORS witness Christina Stutz, dated May 3, 2012. On page 7, lines 13-18 of her
9 testimony, she states,

10 “Adjustment 18 – ORS proposes to adjust bad debt expense at a rate of
11 0.5% applied to pro forma metered revenues of \$414,335 and a rate of
12 2.50% applied to pro forma availability billing revenues of \$290,416. The
13 Applicant’s factors were considered reasonable by the ORS Water and
14 Wastewater Department. ORS computed total bad debt expense of
15 \$9,332, less the per book amount of \$25,423, for a total adjustment of
16 (\$16,091).”

17 Two important observations can be made from Ms. Stutz’s testimony from the 2012 rate
18 case. 1) ORS determined that the total combined system bad debt expense should have
19 been only \$9,332 on pro forma revenues of \$714,996, representing a composite rate of
20 1.31%. 2) ORS believed in 2012 that appropriate rates for bad debt expense should be
21 0.5% for rate revenues and 2.5% for availability billings.

As shown in Table 1, below, I then applied the 0.5% and 2.5% rates to the Company's Pro Forma Present Rate revenues from its application and calculated exactly the amounts that the Company used in the Application, \$6,676 for the Water System and \$8,086 for the Sewer System.

Table 1

DIUC Bad Debt Expense Calculation and Adjustment Per Application				
		Combined	Water	Sewer
Rate Revenue		\$580,779	\$324,389	\$256,390
Bad Debt Rate			0.500%	0.500%
Bad Debt Expense		\$2,904	\$1,622	\$1,282
Availability Revenue		\$474,327	\$202,156	\$272,171
Bad Debt Rate			2.500%	2.500%
Bad Debt Expense		\$11,858	\$5,054	\$6,804
Total		\$14,762	\$6,676	\$8,086
DIUC Per Books		\$105,668	\$52,834	\$52,834
Difference (DIUC Adjustment)		(\$90,906)	(\$46,158)	(\$44,748)

This, combined with the ORS adjusted bad debt expense of \$9,332 on pro forma adjusted revenues of \$714,996, leads to the obvious conclusion that ORS believed that the appropriate level of bad debt expense was on the order of a 1.3% composite rate, and secondly, and more importantly, reveals that the Company very intentionally calculated an adjusted bad debt rate in its Application, based EXACTLY on the rates used by Ms. Stutz in the 2012 rate case. I can only conclude that the Company believed that in its Application, ORS would absolutely not accept a bad debt expense of \$105,667 or almost 10% of revenues, a rate almost 8 times the 1.3% rate from the 2012 rate case. Thus, in my direct testimony for the first hearing in this case, I accepted the Company's bad debt

1 expense of -\$90,905, resulting in a very reasonable rate of 1.36% of adjusted present
2 revenue. My Exhibit **LML-R3**, attached hereto, also reflects that adjustment.

3 **Q. ARE YOU AWARE OF WHAT THE SUPREME COURT SAID IN ITS**
4 **DECISION ON THE APPEAL OF DIUC, IN THIS MATTER, WITH RESPECT**
5 **TO BAD DEBT EXPENSE?**

6 **A.** Yes, I am. In its opinion, the Court stated that

7 “the Commission’s decision to allow a bad debt expense of \$30,852 is
8 unsupported by the evidence in the record.” (underling added for
9 emphasis).

10 Notably, the Court did not provide any specific direction to the Commission in
11 remanding the matter back to the Commission for further consideration, but basically said
12 that whatever the Commission decides on bad expense, should be based on the evidence
13 in the record.

14 **Q. SO, WHAT IS YOUR CONCLUSION IN REGARD TO THE APPROPRIATE**
15 **LEVEL OF BAD DEBT EXPENSE.**

16 **A.** While I am reluctant to be critical of ORS, on this particular item I believe that ORS
17 failed to fully analyze the Company’s actual test year bad debt expense and failed to
18 consider the prudence of the amount of \$105,667, an amount representing almost 10% of
19 revenues. In both the 2012 rate case and in this one, ORS first said that the bad debt
20 expense should be 0.5% of revenue and then, in this case, computed an amount almost 20
21 times that rate. Furthermore, from the Company’s history, going back to the 2012 rate
22 case, ORS had information and knew what the Company’s historical bad debt expense
23 rate was and should reasonably be, and it is not almost 10%. Perhaps more importantly,
24 if the Company, in its application, very intentionally adjusted its bad debt expense down

1 to a level that even it believed to be more reasonable and more acceptable to ORS, why
2 should ORS take it upon itself to adjust the bad debt expense back to the Company's
3 actual booked amount, an amount that is clearly beyond any reasonable level of bad debt
4 expense. So, in my determination of revenue requirements, I am proposing exactly what
5 the Company included in its Application, 0.5% on water and sewer rate revenues and
6 2.5% on water and sewer availability revenues, reflecting a somewhat greater difficulty in
7 collecting availability billings vs metered water and sewer service, that may be
8 disconnected to coerce payment.

9 **Q. WHAT ARE YOUR RECOMMENDATIONS WITH RESPECT TO THE OTHER**
10 **OPERATING EXPENSES OF THE COMPANY?**

11 **A.** With the exception of outside management services and bad debt expense, the Company
12 did not challenge the ORS proposed O&M Expense Adjustments in its direct testimony
13 for the rehearing. Thus, with one exception, I have accepted all of the ORS operating
14 expense adjustments in my determination of overall revenue requirements. The
15 exception is the adjustment for power cost. In my analysis, as shown in my direct
16 testimony for the first hearing in this matter, I determined that the Company's adjustment
17 for power cost should be reduced by \$34,841, whereas ORS recommended a decrease of
18 only \$14,744. While I understand how ORS arrived at its proposed adjustment, I believe
19 that my analysis is more thorough and that my proposed adjustment of -\$34,841 is more
20 accurate and appropriate and, therefore, I have used my adjustment for power cost.

21 **Q. WHAT IS YOUR PROPOSAL FOR DEPRECIATION AND AMORTIZATION**
22 **EXPENSES?**

1 **A.** In his testimony, Mr. Loy addressed depreciation and amortization expense, as it relates
2 to the DIUC utility plant and the amortization CIAC. For convenience, I have provided a
3 summary of his depreciation and amortization adjustments, in the table, below. I have
4 utilized the depreciation adjustments provided in my revenue requirements analysis. My
5 Amortization Expense of \$93,532, reflected on my Schedule C-4, includes the
6 Amortization of the recalculated back property taxes (discussed below) and the rate case
7 amortization expenses (See Schedule C-5, **Exhibit LML-R3**, item L-4)

8 **Q. WHAT ARE YOU PROPOSING FOR PROPERTY TAX EXPENSES?**

9 **A.** In the Company's Application and as reflected in the testimony of the Company's
10 witnesses, the Company claims that in August 2012 it was notified by the South Carolina
11 Department of Revenue (DOR) and Beaufort County, that it owed property taxes, based
12 on its personal property assets for the years 2009, 2010, 2011, 2012, 2013, and 2014.
13 The DOR and Beaufort agreed to abate the taxes for 2009 and 2010, leaving a total back
14 tax amount of \$526,844. This was based on information that had been obtained by DOR
15 from DIUC's annual report to the PSC. As shown by the assessment reports from DOR,
16 DIUC's personal property assets had been assessed at the rate of 10.5%, resulting in tax
17 valuations upon which Beaufort County had levied taxes. The Company states that it
18 entered into negotiations with Beaufort County in an effort to reduce the amount of tax
19 owed on its personal property assets, which the Company had not been paying prior to
20 2014. As a result, Beaufort County agreed to forego the tax for 2009 and 2010, and allow
21 the Company to pay the amounts owed for 2011-2014, on an installment basis over eight
22 (8) years. The amount for 2015 was determined to be \$192,302, resulting in an
23 adjustment in property tax from \$4,209 actual for 2014 of \$188,092. Thus, in its

Application and testimony, the Company proposed an adjustment in Amortization Expense of \$113,655, to amortize the back taxes owed to Beaufort County over a period of 8 years, to match the agreed upon payment plan with Beaufort County.

As shown on the calculations of the Assessments by DOR, the Assessment is determined, as follows (See DIUC ORS 1.81 Attachment C – DOR Rev. Asses. 2012, 2013, and 2014):

Total South Carolina Net Utility Plant		\$ _____
Less: Adjustments		
S.C. Licensed Vehicles (Net)	\$ _____	
S.C. CWIP	\$ _____	
S.C. CIAC (Net)	\$ _____	
S.C. Intangible Plant	\$ _____	
South Carolina Taxable Value		\$ _____
South Carolina Assessment Ratio		10.5%
South Carolina Proposed Assessment		\$ _____

From this calculation, it is clearly evident that CIAC is netted from the South Carolina Net Utility Plant (Gross Plant less Accumulated Depreciation), in arriving at the assessed value. As Mr. Loy has demonstrated in his testimony, the Company should have booked the \$4,635,782 amount booked to Paid in Capital in the 2005 Rate Case, to CIAC. Had it done so, the Taxable Values of the Company's plant would be much lower, which would have resulted in much lower assessments in 2011, 2012, 2013, 2014, and a lower assessment in 2015. In addition, Mr. Loy's corrected Accumulated Depreciation for each year would have reduced the Company's Net Utility Plant Amount in each year,

including the test year, 2014, and future years. Finally, Mr. Loy's alternative adjustment to set aside a portion of the Company's plant investment as "not used and useful" has the effect of further reducing the Company's Net Utility Plant for DOR tax assessment purposes. Thus, based on his proposed adjustments to the Company's booked plant values for CIAC, for greater accumulated depreciation, and removal of plant that is not used and useful, the Company's Property Tax Assessments would have been much lower and the taxes levied by Beaufort County would have been much lower. In his testimony and exhibits, Mr. Loy recalculated the assessments for each year, based on his recommended changes. Information supplied to me by Mr. Loy is summarized in the Table 2, below.

Table 2

	2011	2012	2013	2014
<u>Estimated Property Taxes With CIAC</u>				
Net Plant	\$4,703,358	\$4,552,231	\$4,526,446	\$5,165,934
Net CIAC	(\$3,076,679)	(\$3,016,352)	(\$2,957,207)	(\$2,899,223)
Taxable Base	\$1,626,679	\$1,535,879	\$1,569,239	\$2,266,711
Assessment Ratio	10.5%	10.5%	10.5%	10.5%
Millage Rate	0.197540	0.200850	0.240033	0.248790
Tax Due	\$33,740	\$32,391	\$39,550	\$59,213
Total Back Taxes			\$164,894	
Total Annual Tax				\$59,213

Based on his recommended changes, the Tax Assessment from 2014, which is the basis for the tax in 2015, would decrease from \$192,302 to \$59,213 and the tax amount from 2011 – 2014 would decrease from a total of \$526,844 to \$164,894.

1 In determining revenue requirements for the Company, based on the 2014 Test Year,
2 adjusted, the Adjusted Property tax for the test year should be \$59,213 and the
3 Amortization of the back-property taxes should be \$20,612, per year.

4 **Q. SINCE DOR HAS ALREADY RENDERED ASSESSMENTS AND BEAUFORT**
5 **COUNTY HAS LEVIED TAXES, BASED ON THE ASSESSMENTS FOR THE**
6 **YEARS 2012 FORWARD, ISN'T THE COMPANY OBLIGATED TO PAY THE**
7 **TAXES OWED FOR PREVIOUS YEARS, EVEN IF THE COMPANY IS ABLE**
8 **TO LOWER ITS ASSESSMENT FOR THE CURRENT AND FUTURE YEARS?**

9 **A.** I have investigated this issue with the DOR and was advised by DOR that South Carolina
10 Code Section Title 12, Section 12-54-85 is applicable to this section. Section F(1) is the
11 operative language, as follows:

12 *“(F)(1) Except as provided un subsection (D), claims for credit or refund*
13 *must be filed within three years from the time the return was filed, or two*
14 *years from the date the tax was paid, whichever is later. ...”*

15 Based on this code section, DIUC should be able to apply for and receive a refund of
16 taxes paid. DIUC should be able to file an amended return for a reduction in its property
17 taxes for 2017 (based on 2016 year-end plant balances) and also file amended returns for
18 2016 and 2015, to reduce the tax owed for those two years. It is likely that DIUC will be
19 unable to achieve any relief or reduction for the 2011-2014 personal property tax, since it
20 has been more than two years since taxes for those years were paid. However, the
21 Amortization Expense included in revenue requirements should reflect the property taxes
22 that the Company should be paying, based on the adjustments in plant and CIAC
23 proposed by Mr. Loy. With respect to the difference between what the Commission
24 authorizes for property tax in this matter, I recommend that the Commission establish a
25 regulatory asset for DIUC that would represent the difference between what the Company

1 is liable for and the amounts that would be collected through the rates approved by the
 2 Commission, and authorize a special rate surcharge, to be amortized over a period of 8
 3 years, and which would be extinguished at the end of such period. Based on the belief
 4 that the Commission will issue an order in this matter before the end of December 2017,
 5 once the order is issued, the Company should immediately file amended returns with the
 6 DOR and Beaufort County to obtain refunds or credits for 2015 and 2016 and to obtain a
 7 lower assessment and property tax amount for 2017 and future years.

8 It should also be noted, as addressed the Commission's No. 2015-846 from the first
 9 hearing, that DIUC has gone back to the Department of Revenue and Beaufort County on
 10 several occasions to request changes in its tax assessment and its tax billings, so there is
 11 every reason to believe that the Company can achieve some relief from its property tax
 12 burden if its Net Plant Investment and Rate Base are reduced by the Commission to the
 13 levels recommended by Mr. Loy and reflected in my testimony.

14 **Q. ARE YOU AWARE OF WHAT THE COURT SAID WITH RESPECT TO THE**
 15 **RECOVERY OF PERSONAL PROPERTY TAX EXPENSE?**

16
 17 **A.** Yes, I am. In the Court's opinion, it stated,

18 "the Commission's suggestion that DIUC may be able to reduce its tax
 19 liability by renegotiating with Beaufort County in the future is purely
 20 speculative, especially in light of Wall's testimony indicating the County
 21 would not be willing to amend the terms of the settlement agreement.
 22 Therefore, we would reverse the Commission's adoption of ORS's
 23 property tax expense adjustment."
 24

25 The Court's decision was related to the disallowance by ORS of plant associated
 26 with the elevated storage tank on property not owned by DIUC. We did not make
 27 that same argument in the first hearing or in this hearing. Our proposed

1 adjustment to property taxes is based on changes in net plant values, as proposed
2 by Mr. Loy, and therefore, it seems entirely reasonable that the on-going property
3 taxes should be based on such net plant values. Therefore, I do not feel that my
4 above recommendation is contrary to the Court's decision as it is based on an
5 entirely different set of facts and I have also provided a mechanism for DIUC to
6 recover any property taxes it is obligated to pay, that are in excess of what would
7 be recovered through the Commission approved rates.

8 **Q. IN YOUR DETERMINATION OF REVENUE REQUIREMENTS, HAVE YOU**
9 **MADE ANY ADJUSTMENTS TO THE COMPANY'S REVENUES?**

10 **A.** Yes. ORS proposed adjustments to the Company's revenues which the Company has
11 accepted and, therefore, I have incorporated those revenue adjustments into my revenue
12 requirements analysis. Those adjustments were relatively insignificant and amounted to a
13 negative \$2,885 in annual revenue.

14 **Q. BASED ON MR. LOY'S PROPOSED ADJUSTMENTS TO RATE BASE AND**
15 **YOUR ADJUSTMENTS TO REVENUES AND EXPENSES, WHAT IS YOUR**
16 **RECOMMENDED REVENUE REQUIREMENT?**

17 **A.** Based on revisions to my Exhibit 3, now referenced as **Exhibit LML-R3**, from my direct
18 testimony in the first hearing in this matter, I have made revisions per this testimony for
19 Plant Investment, Rate Base, and revenue and expense adjustments, as I have outlined
20 above. With respect to the Rate of Return, since I believe that ORS testimony on Rate of
21 Return, Return on Equity, and the Long-Term Debt rate are consistent with what I
22 proposed in my direct testimony for the first hearing and which the Commission adopted
23 in its Order No. 2015-846, I have adopted and used the ORS recommended ROE and
24 Long-term debt rates of 9.31% and 5.29% respectively, for calculating the overall Rate of

1 Return to be applied to Rate Base. Using a capital structure of 46% debt and 54% equity,
2 as approved by the Commission in its Order (See my **Exhibit LML-R3**, Schedules C-3,
3 W-3, and S-3), the weighted cost of capital is 7.46% to be applied to the Rate Base. I
4 have calculated revenue requirements for the Water and Sewer Systems separately and
5 for the Combined System. As shown on my **Exhibit LML-R3**, Schedule C-4, the overall
6 revenue requirement for the combined systems is \$1,293,571, representing an increase of
7 \$219,993 and 20.5% over Pro Forma Adjusted Present Revenue. For the Water System,
8 the revenue requirement is \$712,166, representing an increase of \$169,694 over adjusted
9 present revenues and a 31.3% increase over Pro Forma Adjusted Present Revenues. And
10 for the Sewer System, the revenue requirement is \$581,403, representing an increase of
11 \$50,298 over adjusted present revenues and a 9.5% increase over Pro Forma Adjusted
12 Present Revenues.

13 **Q. IN HIS TESTIMONY, MR. LOY ACTUALLY PRESENTED TWO RATE BASE**
14 **OPTIONS, ONE THAT REFLECTED THE SHIFTING OF “PAID IN CAPITAL”**
15 **TO “CIAC”, WHICH YOU HAVE ADDRESSED ABOVE, AND ONE THAT**
16 **REFLECTED THE APPLICATION OF UTILIZATION FACTORS TO PLANT**
17 **INSTEAD OF THE SHIFT OF PAID IN CAPITAL TO CIAC. HAVE YOU**
18 **DEVELOPED REVENUE REQUIREMENTS BASED ON THIS ALTERNATIVE?**

19 **A.** Yes, but since the Rate Base changes very little between the two alternatives, there is
20 actually not much change in the revenue requirements. I have provided another version
21 of my revenue requirements model as **Exhibit LML-R4**, in which I have removed the
22 adjustments to paid in capital and CIAC and instead applied the utilization adjustment
23 provided by Mr. Loy in his Table 8. Without going into all the detail that I did with
24 respect to **Exhibit LML-R3**, the net effect on revenue requirements under this scenario is

1 an overall increase in the revenue requirement of 25.1%% and for the Water System,
2 29.6%, and for the Sewer System, 20.5% (See Schedules C-4, W-4, and S-4).

3 **Q. IN HIS DIRECT TESTIMONY FOR THE REHEARING OF THIS CASE, MR.**
4 **GUASTELLA HAS INCLUDED AS ATTACHMENT A TO HIS TESTIMONY, A**
5 **STATEMENT ENTITLED “IMPACT OF COMMISSION’S ORDER**
6 **ACCEPTING ORS/POA SETTLEMENT,” WHICH PURPORTS TO**
7 **DEMONSTRATE THAT THE RATES AND CHARGES ALLOWED, PER THE**
8 **COMMISSION’S ORDER, ARE INSUFFICIENT TO ALLOW DIUC TO MEET**
9 **CASH FLOW REQUIREMENTS AND INSUFFICIENT TO MEET THE**
10 **FINANCIAL TESTS IN THE LOAN COVENANTS WITH SUNTRUST BANK.**
11 **HAVE YOU REVIEWED THIS STATEMENT, MR. GUASTELLA’S**
12 **ASSERTIONS, AND DO YOU AGREE WITH THEM?**

13 **A.** I have reviewed Mr. Guastella’s testimony, his ATTACHMENT A, and Loan Covenants
14 attached to his testimony as Exhibit JFG-R1. I first reproduced Mr. Guastella’s Exhibit
15 JFG-R2 and recalculated the numbers to assure accuracy (See **Exhibit LML-R5**). I
16 disagree somewhat with his calculations. Specifically, there is an amortization component
17 of the property tax expense, that provides cash. There is also an amortization of rate case
18 expense that provides cash. I also believe that that there may be a deferral associated
19 with income tax, if not current, then in the future that would provide cash for DSC
20 coverage, so I think the cash flow calculation is somewhat erroneous, and that if
21 corrections are made, the cash flow becomes positive. I was unable to fully document the
22 debt service on the \$2.75 million term loan and the Line of Credit, but I believe the
23 \$278,124 annual amount is reasonably accurate. However, I feel that the representations
24 made, as to the calculations are not accurate. On Exhibit JFG-R2, Mr. Guastella
25 calculated a Debt Service Coverage (DSC) Ratio of 1.03 and claims that it does not pass

1 the SunTrust Bank loan covenant test. He also calculated a Debt to EBITDA ratio of
2 9.26 and claims that it also does not pass the SunTrust Bank load covenant test.

3 In reviewing the SunTrust Loan Covenants included with this testimony, under “Debt
4 Service Coverage Ratio” on page 2 of 5, the agreement states that

5 “The Debt Service Coverage Ratio of the Borrower shall not at the end of each
6 fiscal year be less than 1.2 to 1.0.”

7 While this is rather strangely written, it appears that the minimum DSC is 1.0. Mr.
8 Guastella’s Exhibit JFG-R2 shows that the calculated DSC is 1.03, which I would
9 interpret to mean that it passes the test of 1.0. Exhibit JFG-R2 indicates a minimum DSC
10 of 1.5, but that is not reflected in the loan covenants. There is also no reference in the
11 SunTrust Bank Loan Covenants provided by Mr. Guastella in his testimony to a Debt to
12 EBITDA ratio, so the reference to a ratio of 6.0 or less is meaningless, even if the ratio
13 calculated fails the test. These are material misrepresentations and Mr. Guastella should
14 make corrections for the Commission’s consideration. Furthermore, in his calculations of
15 Net Income, Depreciation, Amortization, and Interest in the DSC calculation, I believe he
16 fails to include the amortization portions of the property tax expense, the rate case
17 expense, and any deferred income tax, such that the DSC calculation is somewhat
18 understated. This would also affect the Debt to EBITDA ratio.

19 So, my conclusion is that JFG-R2 is not entirely accurate and is not conclusive that the
20 SunTrust Bank Loan Covenants would not be met under the revenues allowed by the
21 Commissions original order. In any case though, my revenue requirements analysis, as

1 reflected on my Exhibit **LML-R6**, indicates that the revenues would be sufficient to meet
2 cash flow requirements and meet the loan covenant requirements of SunTrust Bank.

3 **Q. IS THERE ANYTHING ELSE THAT YOU HAVE REVIEWED THAT WOULD**
4 **INDICATE THE REASONABLENESS OR UNREASONABLENESS OF THE**
5 **COMPANY'S PROPOSED OVERALL RATE INCREASE OF 108.9%?**

6 **A.** Yes. I recently obtained a rate comparison from the Beaufort Jasper Water & Sewer
7 Authority (BJWSA) that contains the rates and availability charges of water and sewer
8 utility service providers in the Lowcountry area of South Carolina and particularly in the
9 immediate vicinity of Daufuskie Island. To the survey data, I added the rates and
10 charges, currently being charged by DIUC under bond, and compared those rates to the
11 rates from the survey respondents. The survey, as received from the BJWSA, with the
12 addition of the DIUC rates, is attached as **Exhibit LML-R7**. As clearly shown, the sum
13 of water and sewer rates, based on the rates and charges that DIUC is asking the
14 Commission to approve in this case, and which amount to a 108.9% overall revenue
15 increase, results in rates that are higher than the highest rates shown in the survey and
16 much higher than the survey average. While it may be expected that the costs of
17 providing water and sewer services on Daufuskie Island may be greater than in some
18 nearby areas, for a variety of reasons, I do not believe such differences justify rates 124%
19 higher than the average rates in the general area.

1 **Q. WHAT IS YOUR OVERALL CONCLUSION AND RECOMMENDATION AS TO**
2 **THE RATES AND CHARGES THAT THE COMMISSION SHOULD**
3 **AUTHORIZE DIUC TO COLLECT, PURSUANT TO THE COMPANY'S**
4 **APPLICATION IN THIS CASE?**

5 **A.** My view is that the Company's expenses are excessive and that its expectation for an
6 equity return are equally excessive and that the revenue increases and the rates and
7 charges that the Company would need to charge to cover its excessive expenses and
8 provide the desired return, represent an insensitivity to the interests and concerns of its
9 customers and also ignore the potential impact on the future development of the Island
10 caused by excessively high water and sewer charges and availability fees. As I have
11 stated previously in my direct testimony in this case and the 2012 case, I believe the
12 Commission should provide rate relief to DIUC sufficient to provide the Company an
13 opportunity to earn a "reasonable" return, but not at the cost of a 108.9% rate increase.
14 The Company should also be encouraged by the Commission to seek greater efficiencies
15 in its operations and to also pursue Strategic Alternatives to its continued operation,
16 including sale to or merger with other entities.

17 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

18 **A.** Yes, it does.

19 **END OF DIRECT TESTIMONY**

20

LIST OF EXHIBITS TO ACCOMPANY TESTIMONY

- 1
- 2 **EXHIBIT LML-R1 – [Reserved]**
- 3 **EXHIBIT LML-R2 – [Reserved]**
- 4 **EXHIBIT LML-R3 – LML Revenue Requirements Schedules (Donated Plant)**
- 5 **EXHIBIT LML-R4 – LML Revenue Requirements Schedules (Utilization Factors)**
- 6 **EXHIBIT LML-R5 – Reproduction of Exhibit JFG-R2**
- 7 **EXHIBIT LML-R6 – Cash Flow from Exhibit LML-R3**
- 8 **EXHIBIT LML-R7 – Comparison of Water and Sewer Rates**